VZCZCXRO6944
RR RUEHAG RUEHBC RUEHDE RUEHDIR RUEHKUK RUEHROV
DE RUEHKB #1049/01 2341133
ZNY CCCCC ZZH
R 221133Z AUG 07
FM AMEMBASSY BAKU
TO RUEHC/SECSTATE WASHDC 3725
INFO RUCNMEM/EU MEMBER STATES
RUCNIRA/IRAN COLLECTIVE
RHMFISS/CDR USEUCOM VAIHINGEN GE
RUEAIIA/CIA WASHINGTON DC
RUEKDIA/DIA WASHDC
RHEHNSC/NSC WASHDC

C O N F I D E N T I A L SECTION 01 OF 02 BAKU 001049

SIPDIS

SIPDIS

E.O. 12958: DECL: 08/09/2017
TAGS: PGOV PREL AJ ENRG
SUBJECT: AZERBAIJAN PERTURBED BY TGI ANNOUNCEMENT, TURKISH NETBACK PRICING PROPOSAL

Classified By: Ambassador Anne E. Derse, reasons 1.4 (b,d)

¶1. (C) SUMMARY: In an August 3 meeting with EUR DAS Bryza, SOCAR Vice-President Elshad Nassirov expressed displeasure at the July 26 MOU signed among Turkey, Greece and Italy, saying these countries should not have come to an agreement about "our gas," including gas from the second phase of Shah Deniz development, without including Azerbaijan. (President Aliyev and FM Mammadyarov also expressed their displeasure with the TGI agreement, septel.) Additionally, the GOAJ alleges that the netback pricing scheme for Turkey mentioned in this intergovernmental agreement would result in Azerbaijan being forced to sell a portion of its gas to Turkey at sub-market prices, which the GOAJ is unwilling to do. In a separate conversation with Bryza, Italian Energy Company ENI's Project Leader for the TGI Project Development Team Elio Ruggeri confirmed Nassirov's interpretation of the agreement, but said that the economic losses to Azerabaijan would be "sustainable," and that the GOAJ would have no other options for gas export. A GOAJ negotiating team headed by Energy Minister Aliyev and staffed with Nassirov and MFA Ambassador at large (for Energy) Shamil Aleskerov departed for Ankara on August 7 to negotiate gas transit with the GOT; President Aliyev and other senior GOAJ officials subsequently provided a readout to visiting EEB A/S Sullivan and the Ambassador (septels). END SUMMARY.

¶2. (C) In an August 3 meeting with EUR DAS Bryza, SOCAR Vice-President Elshad Nassirov, reflecting sentiments heard both from President Aliyev and FM Mammadyarov, expressed GOAJ displeasure at the July 26 MOU signed among Turkey, Greece and Italy, saying these countries should not have come to an agreement about "our gas," including gas from the second phase of Shah Deniz development, without including Azerbaijan. As for the agreement itself, Nassirov said the MOU's stipulation that Turkey get 15 percent of transit gas reserved for itself at the netback price paid by Italy was unacceptable for Azerbaijan, as it would result in Azerbaijan having to sell a portion of its export gas at below-market prices, resulting in losses of at least USD 130 million annually for the minimum thirty years of gas export to Europe. Nassirov said he had discussed the Turkish-Greece-Italy Intergovenmental agreement (IGA) with ENI's Project Leader for the IGI Project Development Team Elio Ruggeri, who had confirmed Nassirov's understanding of the mechanisms of how the netback arrangement would work

¶3. (C) Nassirov said that instead of this proposed scheme, which he termed a Turkish "concealed purchase and sales agreement," the GOAJ favored Turkey adopting a transparent tariff regime where the transit charges consisted of Capital

expenditure (capex), operating expenditure (opex), and an explicit profit for Turkey. With such a transparent transit regime through Turkey, the GOAJ (and other potential Caspian gas sellers) would be able to make the commercial calculations necessary to determine as to where to sell its gas. Nassirov said that the better the transit terms were for Azerbaijan, the more gas it would be encouraged to ship through Turkey. Alternatively, if transit conditions offered by Turkey were economically undesirable, Azerbaijan could always reducing gas production, or even shipping GOAJ gas to Europe via Russia.

¶4. (C) Speaking of the GOAJ's gas export options from Turkey, Nassirov said that Azerbaijan could move its gas into either the Trans-Adriatic Pipeline, TGI, Nabucco, or to Haifa, Israel via Ceyhan, although the GOAJ is taking pains to ensure this last option is not bruited publicly, and is working toward a situation where Turkey would build the pipeline to Haifa and Azerbaijan would sell the gas. Nassirov confided that the GOAJ has already signed a (secret) long-term oil supply agreement with Turkey, and was hoping to do the same with gas.

¶5. (C) Nassirov said that the EU should be putting more pressure on Turkey to "act more like Europeans" in adopting a fair and transparent transit regime, even suggesting that the proposed IGA violates EU principles. Any transit regime discussion between Turkey and Azerbaijan should focus only on the amount of Turkish profit per kilometer.

¶6. (C) In this regard, in an August 4 conversation between Ruggeri and Bryza, Ruggeri explained that the IGA netback formula does indeed set a new precedent, but that it also specifies that the transit price must be able to be reflected

in a transparent "capex plus opex plus profit" formula, and must amount to a "reasonable" tariff based on transit tariffs in Greece and Italy. He also said that :

- the Intergovernmental Agreement (IGA) already foresees the obligation to Botas to provide transparent transit tariffs based on Capex plus Opex plus reasonable profit. Such transparent tariffs will be an incentive for future transit projects (from Azerbaijan or Turkmenistan) through Turkey.

- for security of supply at competitive terms for the Turkish market (the first two priorities of the Turkish government, the third being profits from transit services), the IGA foresees that anyone transiting Turkey shall sell to Botas a certain percentage of the gas transited (exclusively for the initial 8 bcm/a of the ITGI project such percentage has been fixed at 15 percent) at the final destination marketnetback price (e.g. price to Italy minus transportation cost between Turkey and Italy). Such price would be lower than the international Turkish price. This provision drives the following considerations:

--- for the ITGI project, Azerbaijani producers will sell to Edison and Depa, in addition to the 8 bcm/a destined to Italy, 1.2 bcm/a (i.e. 15 percent of the 8 bcm/a) for the Turkish market at a price lower the Turkish International price, generating an economic loss that in ENI's understanding could be sustainable. ENI will share the details of this calculation with SOCAR as soon as there is a confidentiality agreement with SOCAR.

SIPDIS

---this provision will act as a precedent for future transit projects through Turkey, but it will not prevent Azerbaijan from selling additional volumes to Turkey at the international price. Indeed, if by 2015 the TGI and Nabucco projects are realized, the gas volumes transiting Turkey will be approximately 40 bcm/a and the gas amount sold to Botas at

European market netback prices will be approximately six bcm/a (i.e. 15 percent of volumes transited) against an overall demand in Turkey that is expected to reach levels in excess of 50 bcm/a. Therefore, the additional Turkish gas requirements could be sold at the international price.

- Ruggeri believes that SOCAR will have a difficult job finding better solutions for transiting Turkey, and that the IGA is a good compromise, in that it provides the commitment of Turkey to provide transit through its network in a transparent way and at market conditions, opening the route for Caspian gas to Europe and asking the shippers (producers and buyers) to contribute to the security and competitiveness of Turkish gas supply.

¶7. (C) Ruggeri also told Bryza that the Italian government plans to approach the GOAJ in order to look into the possibility of a four-party IGA with Turkey, Greece, Azerbaijan and Italy.

¶8. (C) COMMENT: A GOAJ negotiating team headed by Energy Minister Aliyev and staffed with Nassirov and MFA Ambassador at large (for Energy) Shamil Aleskerov departed for Ankara on August 7 to negotiate gas transit with the GOT. Senior GOAJ officials, including President Aliyev, SOCAR President Abdullayev, Finance Minister Sharifov and Minister of Economic Development Babayev, subsequently provided a readout to visiting EEB A/S Sullivan and the Ambassador (septels).

¶9. (U) DAS Bryza did not have the opportunity to clear this message.
DERSE